Political uncertainty and AI concerns spur **market jitters**

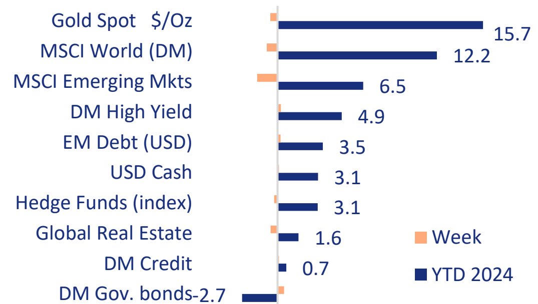
- **Markets mixed on AI concerns and presidential race uncertainty**
- **Macro data confirms our soft-landing scenario is on track**
- **All-important week for central-bank policy US economy and tech earnings**

The US markets ended mixed for a second consecutive week amidst ongoing sector rotations and political change with the endorsement of Kamala Harris in the presidential elections. The Nasdaq lost 2.1%, the Dow Industrials gained 0.7%, and overall large cap growth stocks continued to underperform cyclicals and the smaller companies. The reporting of Tesla and Alphabet threw further doubts on the AI sector, as the former announced tumbling profits and a delay in its robotaxi project, while the latter raised concerns about future returns on AI investments. Yet, investors on Friday took heart from corporate earnings growth for the second quarter being revised higher to 9.8%, pushing benchmarks to close in positive territory for the session.

The data releases confirmed a Goldilocks scenario marked by above-trend GDP growth at 2.8% for the second quarter, and core PCE inflation steady at a 2.6% annual rate. Flash business confidence surveys painting the picture of a two-speed economy with robust services and a struggling manufacturing sector, as well as a softening housing market, did little to alter the view that growth and inflation are just about right for a soft landing. Moderation in price pressures reinforced conviction that the easing process will start with a September cut, followed by up to two cuts by December this year, a view reflected in the market by the steepening of the Treasury curve to record levels for the year.

The current week is going to be eventful, with Microsoft, Meta, and Amazon set to report, the Fed scheduled to announce its policy decision on Wednesday alongside the BOJ, followed by the BOE on Thursday, and the all-important jobs report on Friday. Investors will get important cues about monetary policy, the trajectory of tech earnings, and the state of the main economies.

ASSET CLASSES USD % TOT.RETURN, 2024 & LAST WEEK



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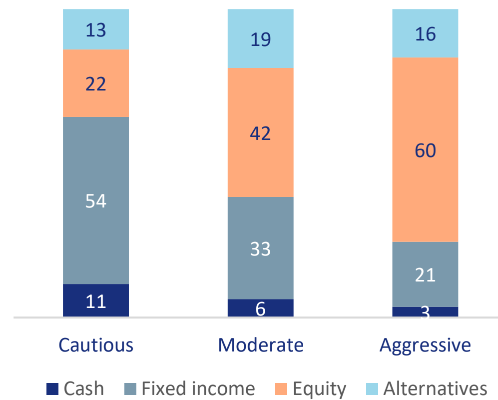
Cross-asset Update

Despite the rising market volatility and the growing uncertainty around the presidential race, we hold the view that fundamentals remain in place for the rally to resume at some point. The release of the second quarter GDP confirms that US growth is resilient, at levels comfortably above trend and driven by sturdy, though slowing consumption, even as inflation continues to moderate. At the same time, policy seems to be restrictive enough to push the Fed to ease from September, and indeed NY Fed's governor Bill Dudley urged that the first cut occurs in July to avoid possible unintended consequences on growth. While investors assign a negligible probability to a first move in July, they will at the same time be scrutinising this week's employment report to check that the soft-landing scenario is on track. Consensus projects US unemployment at 4.1% in June, a level consistent with no recession in sight. Yet, a rise by few tenth of basis points in the share of the unemployed would raise concerns about future growth, triggering the so-called Sahm rule, a technical rule used to anticipate an impending economic contraction. We see markets continue to lay emphasis on hard data rather than on business surveys, due out this week across the major developed countries, so the jobs report is particularly critical at this juncture as a tool to discriminate between opposite scenarios on economic growth.

In this central-bank-heavy week the focus will be on the Bank of Japan on Wednesday, expected to intervene with a renewed rate hike, as well as by curbing its asset purchases. Markets have to an extent already discounted the outcome, pushing the dollar close to a three-month low against the yen. BOJ officials will be very careful to convey a message of gradual tightening, to avoid unravelling of market conditions that would be standing in the way of the fledgling reflationary process.

In the big macro areas US exceptionalism continues to dominate, as economic activity both in Europe and China is subdued with no new catalysts on the horizon. The UK, with cheap equity valuations and a nicely recovering economy, is an exception in the DM landscape. The Bank of England is expected to soon kick off a slow cycle of interest rate cuts, while the new Labour government, being handed over a dire inheritance from the Tories, may be able to restructure, though not to spend as much as feared by investors. The value-skewed FTSE 100 is up only in the high single-digits year-to-date and seems to be ready to go for more, benefitting from the current sector rotations from growth sectors into the more cyclical pockets of the markets. Our equity specialists recently went overweight the UK, and rightly so.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

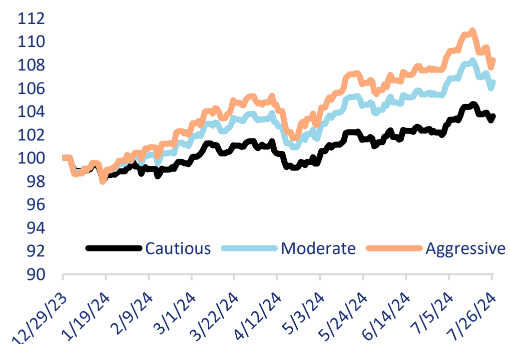


TAA – RELATIVE POSITIONING – MODERATE PROFILE

UW/N/OW: Underweight/Neutral/Overweight

	UW	N	OW
Cash			>
DM Gov.			>>
DM Credit		=	
DM H. Yield		=	
EM Debt	<		
DM Equity		=	
EM Equity		=	
Gold			>
Hedge Funds	<<		
Real Estate	<		

TAA – 2024 INDICATIVE PERFORMANCE



Source: Bloomberg. CIO Office calculation based on TAA applied to market indices, net total return in USD.

Fixed Income Update

During the week, the US Treasury yield curve bull steepened as market participants factored in expectations for further easing by the Federal Reserve and continued improvement in US inflation data. The yields on 2-year, 5-year, and 10-year bonds fell by 13bps, 9bps, and 6bps, respectively, closing at 4.38%, 4.07%, and 4.18%. The Fed funds futures market is now pricing in over 25 basis points of rate cuts by the September FOMC meeting and a total of 70 basis points of cuts by the end of 2024. The 2-year US Treasury is currently trading at the lowest level since mid-February. The week began with 2-year yields dropping on robust demand at the 2-year UST auction on Monday, followed by remarks by former Fed Governor Bill Dudley on Wednesday. Dudley noted that inflation pressures had “abated significantly” and warned that delaying rate cuts could increase the risk of a recession in the US, suggesting that the Fed should not wait until September to lower rates, given the cooling growth and softening labor market.

On macroeconomic updates, US GDP growth for Q2 was significantly stronger than expected at 2.8% annualized, compared to the median forecast of 2.0% and the Q1 growth of 1.4%. Core PCE inflation, the Fed’s preferred measure, was in line with the forecast at 0.2% month-on-month. The year-over-year rate increased to 2.6%, slightly above consensus expectations for a 2.5% increase. The week remains crucial with upcoming policy decisions from the US, UK, and Japan. Our ENBD research house predicts the US and UK central banks to make their first move in the September meeting. The Turkish central bank maintained its benchmark one-week repo rate at 50% as anticipated.

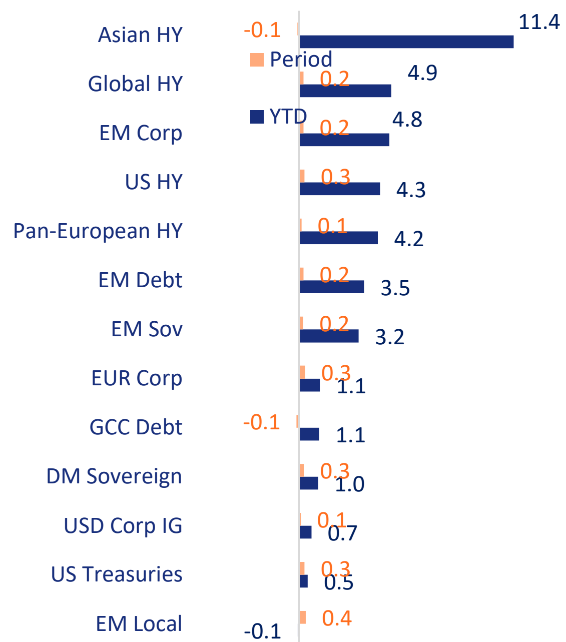
Credit spreads widened across indices, with Bloomberg benchmark spreads for GCC, high-yield, and emerging market debt widening by 10bps, 8bps, and 5bps, respectively, while spreads for investment-grade stayed steady during the week. This widening was driven by expectations of lower-than-forecasted earnings. According to JPM, the uncertainty surrounding the US election continues to impact emerging markets, despite strong fundamentals and anticipated rate cuts.

In the Asia region, India’s FY2025 budget presentation aims to reduce the fiscal deficit to 4.9% of GDP, down from the interim target of 5.1% for FY25. This follows a surprising fiscal deficit of 5.6% of GDP in FY24, which was lower than the target of 5.8%. Additionally, the government has committed to a fiscal deficit below 4.5% of GDP in FY26 and plans to align future fiscal deficit targets to ensure central government public debt declines as a percentage of GDP. Despite these fiscal consolidation efforts, the government has maintained its capital expenditure target at 3.4% of GDP, representing a 17% year-on-year increase from FY24. We like a few infrastructure corporates and non-banking financial companies from the region.

FIXED INCOME KEY CONVICTIONS (2024)

DEVELOPED MARKETS
Overall overweight DM FI
OW Government Bonds
Neutral corporate (IG & HY)
EMERGING MARKETS
Overall UW EM Debt
Favor quality and selectivity

FIXED INCOME SUB ASSET CLASS RETURNS (YTD, LAST WEEK)



Source: Bloomberg

Equity Update

Global equities ended overall lower last week (MSCI ACWI -0.9%), yet got a boost on Friday after good soft-landing data bolstered speculation that the Fed may cut rates as soon as September. A broad tech sell-off was triggered by a disappointing start to the megacap earnings season, with the S&P 500 index down 0.8% last week. However, US data provided some relief on Friday with a GDP beat.

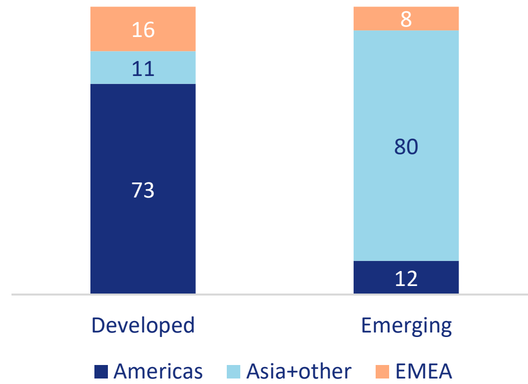
We are now close to the mid-point of the Q2 earnings season, and the S&P 500 has shown overall mixed results so far. The percentage of companies reporting positive earnings surprises is above average levels, while the magnitude of the earnings is lower. Tesla and Alphabet reported last week, and both sold off after a disappointing release. Tesla reported a 25% slump in quarterly profits as price pressures intensify, while Alphabet witnessed a slowdown in advertising growth. Friday's gains were fueled by economically sensitive stocks that welcomed the outlook for rate cuts. So far in July, sectors such as financials, industrials and consumer staples have largely beaten tech, and the equal-weighted S&P 500 Index has outperformed the cap-weighted index for a third straight week.

This week's earnings reports will be a crucial test for the market after a mixed start. 171 companies within the S&P 500 are set to report with a focus on Apple, Microsoft, Amazon, and Meta Platforms. Apple was further pressured recently as preliminary data indicated that the iPhone lost more ground in China last quarter; Chinese smartphone makers such as Huawei and Xiaomi led growth in demand and volumes. Investors will look into Apple's plans to integrate AI within its devices, a major catalyst. Meta Platforms and Amazon will be tested by investors to see whether AI is moving the needle for revenue.

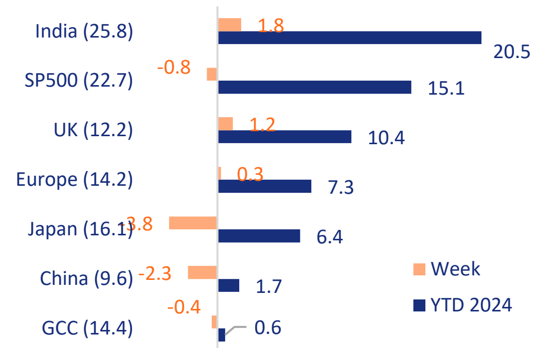
The Japanese yen appreciated tremendously to 153.8 per dollar as traders bet a policy turning point is near, with growing expectations that the interest rate gap between Japan and the US is finally set to shrink. The yen's rally will create a degree of caution in the near term for export-oriented stocks and companies heavily dependent on borrowing. The TOPIX index lost 5.6% last week, with tech names such as Tokyo Electron leading losses. The banking sector gained in anticipation of a decision to hike. The MSCI China Index closed 2.3% lower after markets interpreted the central bank's urgency to cut several benchmark lending rates as a sign that deflationary pressures and weak consumer demand are more severe than previously expected.

Elsewhere, luxury European stocks reported mixed but mostly disappointing earnings amidst Chinese and US consumers reining in spending, the latter burning through excessive pandemic savings. With more than a quarter of the MSCI Europe firms having reported so far, less than half beat earnings estimates. Overall, healthcare companies were the best performers lead by Roche and Sanofi for the week, while autos were the biggest laggards after Renault and Stellantis plunged after reporting.

EQUITY RECOMMENDED REGIONAL POSITIONING

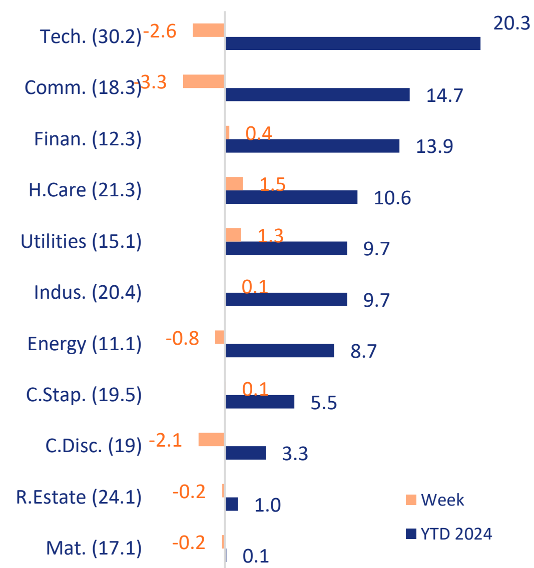


MAJOR INDICES PERFORMANCE (TR, US$), P/E in brackets



Source: Bloomberg consensus. MSCI Indices unless specified.

GLOBAL SECTOR PERFORMANCE (TR, US$), P/E in brackets



Source: Bloomberg consensus. MSCI All Country World sectors US$.

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